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DUTY OF OWNERS OF RAILROAD SECURITIES IN THE PRESENT RAILROAD CRISIS

ADDRESS BY JOHN J. PULLEY

President Emigrant Industrial Savings Bank, New York City  
President Savings Banks Association of the State of New York

Before The Annual Convention

NEW YORK STATE BANKERS ASSOCIATION

AT ATLANTIC CITY, NEW JERSEY

JUNE 24, 1921

The dark clouds of depression which overhang the financial and industrial atmosphere, mark the coming dawn of a new and revitalized economic day. There is no justification for pessimism. The attendant jolts of business readjustment necessarily bring severe shocks, but they are temporary. The only difference in the present difficulties as compared with those which have gone before, is in degree; the force of the current is stronger and wider. The struggle is intense, principally because the majority of us seek to readjust backward instead of forward; we seek the solution of problems by old methods, when generally the old methods are responsible for the problems. There is no better illustration of the application of this principle than the present railroad situation. For years the banking system of the nation which parallels the railroad system as an economic factor, fumbled along with obsolete methods lacking coordination and experiencing periodic depressions and crises until the American business man bank depositor, who was affected most by recurrent disturbances, demanded the development of a science of banking.

We may recall that most bankers actually retarded the development of a new reserve system chiefly because of the difficulty in reconciling their old methods of doing business with a system which would require coordination of the facilities of banking and designed to prevent in every future decade a wide-spread financial disaster. Banking and transportation services are commodities which get production to the consumer. Both are essential public service; both are carefully regulated and supervised; the only difference in the two forms of service is that since the inauguration of the Federal Reserve system, banking has developed a science; the bank manager is in a professional class of toilers, - while the railroads have continued to develop

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along highly competitive lines without recognition of any science of transportation. Banking has coordinated its intelligence and energy in a great and enduring reserve system, of banks, as a protection against public misunderstanding and vicious propaganda. There is stability and soundness to the American banking system. On the other hand, the American railroad system utterly lacks coordination. It is the target of vicious propagandists because they find their ammunition effective.

M. W. L. Aug. 11, '29

The security owner has deplored for years the recurrent depressions in railroad security market values as evidencing a lack of fundamental stability in the market, all of which served to shake his faith in the railroad security as a safe investment. Notwithstanding this depressed state of mind and apparent lack of confidence, the fact remained that the investor was the owner of ten and one-half billions of railway indebtedness without a cent of sinking fund in any of the railroads for meeting maturities. Railway indebtedness has always been considered by management as permanent and in the case of maturities, like when the farmer first viewed a giraffe, he said "There ain't no sech animal". Railway maturities are like mile-posts increasing mileage on the way; they increase indebtedness by refunding.

Until the organization of the National Association of Owners of Railroad Securities, holders of railroad bonds were without adequate protective representation. It was never considered that bond holders needed protection previous to default with its consequent losses and difficulties. These bond holders principally the institutional investors, in charge of vast trust funds in which 50% of the American public has a financial interest, were far in the background for a long period of time, when consideration was sought for the railroads from the Interstate Commerce Commission, from the public and from legislative and other bodies. For years the railroads appeared at hearings of the Interstate Commerce Commission as criminals before the Bar. Whether these conditions arose from methods of misguided public policy on the part of railroad executives or because of political or other reasons it was thought that the owners of the properties, -the holders of railroad securities, -were not concerned. A crisis arose and the time had arrived when the owners of the securities of the railroads must organize for their mutual protection. A meeting was held in Baltimore and

out of that meeting came the National Association of Owners of Railroad Securities, the only real agency through which railroad investors as a body can speak. That Association has developed until today it represents nearly \$12,000,000,000 of railroad securities in its membership. Its influence is far reaching for it has committees organized or in the process of organization in more than 500 cities throughout the country. The committees of the Association contain about 200 men of prominence in their respective communities representing all shades of opinion.

I differ from those who seek to differentiate between stockholders and bondholders. The Association of security owners represents large ownership of stock in addition to ownership of bonds. Their interests are much alike, particularly in such days as these when few railroads are earning the interest on their bonds. But the bondholders have the prior lien on these properties although without voting power and that lien is now subjected to great loss if the railroads are not placed in a position to make sufficient earnings to protect their bonds.

The Association of security owners has no desire to interfere with the stockholders' right of electing railroad managements, but when the owners of railroad securities see veritable chaos in railroad management, is it not entirely proper for them to assert their right of inquiry?

The great investment and financial institutions of Great Britain permanently retain engineering advice in respect to property invested in not only during the stages of investigation and construction but also during this subsequent period of operation. Thus the owners are protected against mistakes of the operating staff, particularly when the property is located a long distance from the investor. This protection is given by periodic examinations and reports from consulting advisers competent to see that money spent on the property is earning a fair return by proper management and maintenance. In this country consulting engineers are usually retained to make a report on the property which if favorable is frequently used with a circular soliciting a subscription to bonds and the services of the engineer have generally been dispensed with on the completion of such report. In Great Britain it is precisely at this point that the work of the consulting engineer becomes of greatest aid.

A British trustee investor would be considered most unbusinesslike if he did not follow the expenditures of the funds loaned and to make sure that the property is at all times efficiently managed. It seems peculiar that this failure to utilize independent and experienced engineering talent has been the exact custom of many American investors.

But, gentlemen, with vast calls which will be made on sources of American capital in the next decade to finance foreign enterprise and to care for our own domestic needs, this efficient British system of protection against loss in investment by scientific watchfulness of the operation of properties securing the investment must be adopted by the American investor. It was in part with a view toward such protection that the Association of security owners recently appointed a Board of Economics and Engineering composed of such distinguished engineers as John F. Stevens, John F. Wallace, L. B. Stillwell, W. W. Colpitts, Col. F. A. Molitor, and W. L. Darling, about which I intend to refer later in this discussion.

The owners of railroad securities have a distinct duty to perform in the present railroad crisis. The results obtained through their organization, the Association of Owners of Railroad Securities, since its organization in the early part of 1917, have many times justified its establishment. In the present crisis this Association of security owners is the only agency thoroughly representative of the holders of railroad bonds and railroad securities which is making constructive suggestions and through its activities and counsel making effective efforts to solve railroad problems. The first appearance of the Association was in 1917 before the Interstate Commerce Commission in the fifteen percent rate increase case. It was the first time the security owners of the country were ever heard collectively on the subject affecting them and a marked impression was left on the Commission. From that day there has been a march of progress on the part of those who are active in the Association's work. Next came the standard form of railroad contract under federal control. The work of the Association secured vital provisions in the form of that contract. Then came the Esch-Cummings Act in which the Association took a foremost part. Its efforts met with great success for the financial provisions were gotten in to the Act chiefly through the intelligent and effective work of the Association of security owners.

The Association of security owners has taken a leading position in the present railroad crisis, because it is convinced that through its activities and cooperation with the Interstate Commerce Commission and the railroads, a solution of railroad problems can be solved and be made to produce a return essential to enable the railroads to finance their obligations.

The advanced position which the Association has taken in the appointment of a Board of Economics and Engineering, indicated the dominant position which is the duty of the owners of railroad securities to take, although such dominant position is controlled only by a desire to be thoroughly helpful in making private operation satisfactory to the public and the investor and to preclude any necessity for Government operation. It is important to describe the functions of this Board of Economics and Engineering. No member of it is connected with a railroad company or with any financial institution. The Board is unhampered by ties of individual, railroad or financial identity or ownership, or by the influences of any particular security owning or banking group; it is free from the environment that attends Governmental appointment. It can pursue its investigations and reach conclusions solely with the purpose of securing the substantial economies that can be made in the public interest, only possible of attainment by those in position to view the transportation system as a whole. The same results cannot be expected to be attained through voluntary agencies, associations or instrumentalities composed of officials of individual railroads or systems, surrounded by the compelling influences that are necessarily entailed upon those who represent the competitive interest of their respective railroads. The railroads have been organized and are operated under highly competitive methods of administration. And while competition should be encouraged and provided for between the railroad systems, it must be kept within reasonable limits and the results of competitive service obtained without the wastefulness that is unavoidable under the present system under which transportation by rail is conducted. No other instrumentality for carrying out the full purposes contemplated by the Esch-Cummins Act in respect to economies or consolidations could be devised that would be so free to cooperate with the Commission and the railroads in solving, in the public interest, the problems now confronting the railroads, as this Board of Economics and Engineering, constituted and appointed as



it has been. The experience of the members of this Board in economic investigations and railroad construction and operation has been exceptionally broad and varied and especially qualifies them for the present undertaking.

The appointment of the Board and its functioning, considering the high character of the personnel, assures for the security owners the utmost practicability of its plans. We are convinced that any further immediate reduction in the wages of labor is out of the question. Freight rates cannot be materially reduced for some time. Hence the Association believes that through the institution of far-reaching economies in railroad operation a satisfactory adjustment of rates and fares could be brought about.

There are two directions in which economies are to be instituted; one, by effecting an organization of the officials of the railroads as grouped in each of the four territories now established by the Interstate Commerce Commission; two, through a central agency or corporation to supply equipment to the railroads without profit to the corporation and to perform other services under the supervision of the Commission.

A Board of experts is already functioning and certain members of the Board are this week testifying before the Senate Committee on Interstate Commerce in favor of the practicability of the Association's plan for producing economies in railroad operation. The Board is essentially an advisory body in respect to the possibilities of economies to be secured through the suggestions and proposals described in the Association's plans. At present the Board has under investigation various ramifications of railroad operation and is ascertaining what economies could be made in the standardization of equipment in the repair of rolling stock and in shop practices.

They are making studies of power economies, including locomotive improvements and electrification. They are finding out what economies could be made in car service and in the joint use of freight and passenger terminals. Studies are being made of loss and damage and the great saving that could be made in proper coordination in that respect. They are analyzing the routing of traffic in order to suggest savings that could be made by the railroads, getting together in that important phase of railroad operation. They are studying what could be saved by the railroads of the country through joint action by the railroads in respect to the purchase of fuel, materials and supplies. The savings to be made in the simplification of accounting and the



proper adjustment of traffic rates and divisions as well as wages and working conditions.

This wide range of investigation unquestionably will contribute vastly to the solution of railroad problems. This is the first step in the development of a real science of transportation.

The Board of experts has called into consultation representatives of car manufacturing companies in order to adopt standard methods in respect to equipment. This Board of experts will develop an important service to investors generally, regardless of the present plan of the Association, for they will be at all times available to Association membership in watching scientifically railroad operation and railroad management.

In the development of the Association's plan, it is at present proposing, their advice may be thoroughly depended upon. The Association's plans propose the effecting of these economies by a group organization of the carriers of the country. It is the logical outcome of the group method for making rates.

The Commission in accordance with the Transportation Act, divided the country into four districts or groups and applied different percentages of increase in rates for the several districts. On the aggregate value of the railroad property in each district the yield from rates was computed in accordance with the Esch-Cummings Law. Since rates are made on the basis of all the carriers in each group, it is entirely consistent to seek reduction in operating costs by groups. The Association proposes that this group organization will be brought about by the railroads themselves. Five railroad officials to be selected by and from among the railroads within each group, will consist a group railway board. They will be responsible for studying the various phases of railroad operation by selecting the men on the railroads of the group best qualified in these various phases and in such a way to investigate and report advanced methods for producing economies through the railroads jointly using their various facilities for transportation and in standardizing machinery and equipment.

When it is considered that there are over two thousand different types of freight cars in the United States, it is reasonable to assume that such studies will produce most far-reaching economies.

Respecting the national organization three officials are to be selected from each of the four group boards, twelve in all, to serve on a national board, with twelve additional members selected from the trustees of the National Railway Service Corporation. Thus this national board would be composed of practical railway officials and men trained in finance and general business administration. This board would possibly not meet more than four or five times a year and then only to determine on the questions of legislation and public policy. On the other hand, the Board of Economics and Engineering will stand in an advisory position in respect to the group and national organizations. It is preposterous to assume that this program as charged, will mean the creation of new government boards, and unnecessary machinery. It is the only thing which will effectively remove the railroads from the realm of federal control and if the principle upon which it is based is not accepted, in my judgment federal control and eventually government ownership are inevitable.

It is far from the intention of the Association of security owners to have the group boards or national board operate the railroads. Their functions will be purely advisory. They would not interfere with the Boards of Directors of railroads. The studies of the boards would be submitted to the directors of the respective railroads, thus keeping before the directors the relation of coordination to economical management. Boards of Directors will function more than ever before. The plan provides a getting together process of the railroads. This has never been accomplished in the past, though the railroads have had their voluntary Association of Executives for a number of years, which has acted without the knowledge of railroad directorates on matters which have been found to be wholly impracticable and unworkable because of the high degree of competition constantly maintained.

The organization described would develop the long needed science of transportation I referred to previously. It would give to the railroads a "Federal Reserve System" of transportation. It would scientifically assemble information available to the shippers and the public as to what relation railroad rates bear to commerce. The lack of this information in the recent past is responsible for many difficulties the railroads are now experiencing.

The organization would bring together railroad intelligence, put it through the most expert engineering skill available and grind it into correct and unassailable principles and policies of railroad transportation. The Board of Economics and Engineering will take up the questions involved in railroad consolidations in which the security owner must be interested vitally. It is incumbent upon the Association of security owners, representing as it does such a vast amount of railroad securities, to prepare to meet the conditions which surround the railroads that issued them. A requirement to the solution of the questions involved is an impartial tribunal composed of competent men such as those on the Association's Board of Engineers to work out in cooperation with those who will cooperate, including the Interstate Commerce Commission and railroad officials, the solution of this tremendous problem. Since all consolidations will require in the main the consent of those who own the securities of the railroads to be consolidated, the cooperation of an association representing so large a proportion of such securities should be of great assistance. It is desirable to hold consolidations within reasonable limits so as not to impair incentive and retard railroad construction into territories awaiting development. When it is considered that two-thirds of the country's area is yet to be developed from a transportation standpoint, the importance of placing no obstacles in the way of extending such facilities is very evident.

The obvious necessity of the group plan, using the groups already established by the Commission, being put into operation, cannot be overemphasized. The conditions of railroads within each of the four groups are similar. The reduction of railroad rates to any large extent essentially depends upon the institution of major economies by the coordination by groups of railroad terminal facilities, track and other facilities. Joint action by the railroads in groups in respect to purchases of fuel, materials and supplies, it is estimated would institute an annual saving of one half billion dollars. In addition observe what effect such cooperation would have upon the multitudinous industries dependent for support on the railroads. The coal miners would be kept at normal production throughout the year. The equipment manufacturers would be enabled to anticipate the needs of the railroads well in advance of the demand for equipment. Credit would be measurably improved and such coordination would best serve to stabilize

business generally. Manifestly this getting together or coordinative process is impossible of attainment if left to the voluntary action of railway management. It must be required of the railroads not by legislative mandate, but by legislative pressure and induced or instigated by the collective influence of the owners of railroad securities. There is not a banker in this Association or in the country who does not earnestly desire the proper solution of railroad problems on the basis of the nearest approach to a permanent solution. That permanent solution can only be found by the method suggested by the Association of security owners,--through the railroads themselves being required to coordinate railroad service and facilities. It is the only way in which private operation will survive. It is upon that basis the Association will stand or fall. Far better it would be were the security owners to ask the Government to take over the properties and pay for them rather than to risk a return to old methods under highly competitive railway organization. It is the sole way in which railway transportation as a whole will further develop and adequately serve the public, it will unquestionably equalize transportation and eventually lead to fair, equitable and effective consolidations. This country still has wide areas of virgin territory, awaiting development after the laying of tracks, all of which will come with a rehabilitated railroad system scientifically operated.

The security owners Association last July organized the National Railway Service Corporation following an act of Congress amending the Esch-Cummings Law which gave the Interstate Commerce Commission the power to make loans to such a corporation,--which became an agency of the Commission,--out of the revolving fund of \$300,000,000 provided in the Law. This Corporation which operates without profit, was organized for the purpose of financing and furnishing cars and locomotives to railroads. Already a number of carriers otherwise unable to secure funds to purchase equipment, have been furnished equipment by the Corporation on a very satisfactory basis. This Corporation should not only supply carriers with equipment under long time yearly payments, but if so provided by Congress, it would be enabled to acquire a "floating supply" of equipment to be leased to carriers on a per diem basis. The railroads would largely reduce their capitalization for equipment, making purchases to meet only their normal requirements, securing from the Service Corporation the equipment to meet seasonal demands.

Large savings would be made in the initial cost of equipment and a greatly reduced number of cars required, the floating equipment being shifted from one railroad to another and from one section of the country to another. When it is observed that there are approximately 300,000 freight train cars in the aggregate, owned by the carriers of the country and used on the average of only two months in the year, it is highly important that this suggested Pullman Company of freight, the National Railway Service Corporation, be enabled to function to the uttermost. Since bankers are interested in the improvement of short time credits which materially follows the facilitation of an adequate movement of equipment which permits the prompt liquidation of short indebtedness, it is reasonable to assume that regardless of their owning railroad securities they would unanimously favor the present activities of the Association of security owners which is responsible for the Corporation.

Under the Esch-Cummins law the Commission is required to institute economies if the railroads themselves do not produce them. Excess Government regulation has grown out of the lack of coordination of effort in the railroad system as a whole. It remains for the railroads themselves and it will be done with the aid of the Association to limit Government regulation by the organization of agencies among the railroads themselves which would guarantee to the public and the shippers adequate transportation facilities at rates which the public must be satisfied are in line with intensive economies and wise administration.

This week Mr. Warfield, the president of the Association of security owners, before the Senate Committee on Interstate Commerce, advocated and urged the application of this principle of coordinated relations to the Interstate Commerce Commission and the Railroad Labor Board. That situation has proved ridiculous. It is unthinkable that the Commission which provides rates and fares to operate railroads should have no relations or understanding with the labor board which adjusts wages, now constituting 65% of all operating expenditures. Mr. Warfield asked the question, "Can the Commission in the wording of the Commerce Act, exercise authority to inquire into the management of the business - keep itself informed as to the manner and method in which the same is conducted - have complete information necessary to enable the Com-

mission to perform the duties and objects for which it was created; when Congress, without coordinate relations between the two bodies, charges one with the sole right to fix wages, and the other with the duty of supplying the money from rates to pay them, keep the railroads running and enable them to sell their securities?" It is obvious that the lack of coordination of the railroads/<sup>of</sup> the country suggested the creation of such a strange situation.

In conclusion, I have endeavored to explain to you the far reaching importance of the present activities of the Association of security owners. It was the most appropriate way in my judgment to discuss this all absorbing subject of the "Duty of Owners of Railroad Securities in the Present Railroad Crisis". I believe thoroughly in the essential soundness of the Association's course of action as the only solution to a most vexing problem. The nation has long enough suffered from arterio sclerosis. The walls of the nation's arteries must be softened through the process of coordination to revitalize the diminished credit of the railroads so that investors will invest to readjust facilities forward, not backward, and reduce rates through major economies so that shippers will ship, to stabilize market values so that Investors and Superintendents of Banks and Insurance can sleep and to give the government regulatory bodies the time and opportunity to get out of railroad operation and into railroad regulation.





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